

HOUSE BILL REPORT

HB 3190

As Reported by House Committee On:
Technology, Energy & Communications
Finance

Title: An act relating to providing tax incentives to support the semiconductor cluster in Washington state.

Brief Description: Providing tax incentives to support the semiconductor cluster in the state.

Sponsors: Representatives Wallace, Fromhold, Curtis, Orcutt, Moeller and Dunn.

Brief History:

Committee Activity:

Technology, Energy & Communications: 2/2/06 [DPS];

Finance: 2/6/06 [DPS(TEC)].

Brief Summary of Substitute Bill

- Lowers the Business and Occupation tax rate to 0.275 percent for manufacturers of semiconductor materials.
- Exempts from retail sales and use taxes the acquisition of gases and chemicals used in the manufacturing of semiconductor materials.
- Makes the new incentives contingent on the investment of at least \$350 million in the state of new facilities for the manufacturing of certain advanced semiconductor materials.

HOUSE COMMITTEE ON TECHNOLOGY, ENERGY & COMMUNICATIONS

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Morris, Chair; Kilmer, Vice Chair; Crouse, Ranking Minority Member; Haler, Assistant Ranking Minority Member; Ericks, Hankins, Hudgins, Nixon, P. Sullivan, Sump, Takko and Wallace.

Staff: Mark Matteson (786-7145).

Background:

Retail sales and use tax and business and occupation (B&O) tax: The retail sales tax applies to the selling price of tangible personal property and of certain services purchased at retail.

The use tax applies if retail sales tax has not been collected. Both the state and local governments impose sales and use taxes; the state rate is 6.5 percent and the average local rate is 2 percent statewide. Sales taxes are collected by the seller from the buyer at the time of sale. Use tax is remitted directly to the Department of Revenue (DOR). State revenues are deposited to the State General Fund.

The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. A business may have more than one B&O tax rate, depending on the types of activities conducted. For example, the rate for most persons that conduct manufacturing or processing for hire activities is 0.484 percent.

Unless specifically exempt, all transactions or uses of property or services in the tax base are subject to retail sales and use taxes, and all business activity in the B&O tax base are subject to the B&O tax.

Semiconductor cluster incentives: In the 2003 session the Legislature enacted a package of incentives for manufacturers of semiconductor materials, including silicon crystals, silicon ingots, raw polished wafers, compound semiconductors, integrated circuits, and microchips, contingent upon a major investment in a microchip fabrication facility in the state. The package included:

- a preferential B&O tax rate of 0.275 percent;
- an exemption for gases and chemicals used in semiconductor manufacturing from retail sales and use tax;
- an exemption for the construction of new semiconductor manufacturing buildings from retail sales and use tax;
- a B&O tax job credit of \$3,000 for each employment position in semiconductor manufacturing production; and
- an exemption of machinery and equipment used in manufacturing semiconductor materials from property taxation.

Firms using the incentives are required to provide an annual report detailing employment, wages, and employer provided health and retirement benefits at the manufacturing site. The report may be disclosed to the public upon request. In addition, the fiscal committees of the Legislature are required to evaluate the effectiveness of the incentive program five and then 11 years after the incentives become effective.

Availability of the semiconductor incentives is contingent upon a determination by the DOR that a contract has been signed for an investment of at least \$1 billion in a semiconductor microchip manufacturing facility. After becoming effective, the incentives expire 12 years later. As of January 2006, no determination had yet been made.

Recent semiconductor market activity in Washington. In December 2004, the parent company of Shin-Etsu Handotai (SEH) announced plans for a new manufacturing facility for 300 millimeter (mm) wafers in Vancouver, Washington. According to the company's web site, SEH was the largest producer of silicon wafers at the end of 2004 and seeks to increase its

manufacturing capacity for the 300mm wafers from 300,000 per month worldwide to 500,000 per month worldwide by the end of 2006.

Shin-Etsu Handotai maintains a semiconductor materials manufacturing facility in Vancouver, first opened in 1980, that produces single-crystal silicon ingots, polished and epitaxial wafers, and provides technical support for its customers.

Summary of Substitute Bill:

A new package of tax incentives is provided to certain semiconductor material manufacturers, contingent upon a large investment in new or expanded semiconductor manufacturing facilities in the state.

Persons that manufacture or process for hire semiconductor materials are subject to tax under the B&O tax at a rate of 0.275 percent. Semiconductor materials include silicon crystals, silicon ingots, raw polished semiconductor wafers, and compound semiconductor wafers. Persons that manufacture semiconductor materials are also exempt from retail sales and use taxes on the acquisition of gases and chemicals used in the production of semiconductor materials.

Persons that utilize the incentives must submit an annual report by April 30 of each year to the DOR. The legislative fiscal committees are required to evaluate the effectiveness of the incentives. The report and evaluation content and administrative requirements are similar to those under the 2003 legislation pertaining to semiconductor materials manufacturing incentives, but include a few modifications. An extension in submitting the report is allowed if good cause is shown. The report must also be submitted electronically, unless the taxpayer demonstrates to the DOR that it is unable to for good cause.

The incentive package is contingent upon the investment in the state by an advanced semiconductor materials fabrication concern of at least \$350 million in new buildings, the expansion or renovation of existing buildings, tenant improvements to buildings, and machinery and equipment in the buildings, for the purpose of manufacturing advanced semiconductor materials. Advanced semiconductor materials include silicon crystals, and, if at least 300mm in diameter, silicon ingots, raw polished semiconductor wafers, and compound semiconductor wafers. The incentives become effective the month after the DOR determines that the \$350 million investment has been made by the time that commercial production began.

Substitute Bill Compared to Original Bill:

Provides the tax incentives with respect to all semiconductor material manufacturing activities, not just to those activities pertaining to the manufacture of 300 mm ingots or wafers. Clarifies that the commercial operation upon which the contingency is in part based may take place in a renovated building. Makes the intent section and the contingency section of the bill effective 90 days after the session in which the legislation is enacted.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date of Substitute Bill: The bill contains a contingent effective date and takes effect as follows: Sections 2 through 8, the substantive provisions concerning tax incentives for semiconductor materials manufacturing, become effective on the first day of the month following a determination by the DOR that, based on actual expenditures prior to commercial production, an investment of at least \$350 million in an advanced semiconductor materials manufacturing facility has taken place at the time commercial production began. Section 1, the Legislative intent, and section 9, governing the criteria with respect to the effective date for sections 2 through 8, take effect 90 days after adjournment of the session in which the bill passed.

Testimony For: It has been very enlightening to be able to see up close the challenges faced by this industry in order to be competitive in the global economy. It is important to the state to cultivate this industry. In the 2003 legislation, the challenge was to obtain a \$1 billion investment in order to make the incentives come into effect. The fact of the matter is that, in this industry, the up front commitment is not at that magnitude, but rather about \$350 million. Over time, investment may increase to \$1 billion.

Clark County has built a real economic engine with this industry. This bill will add some horsepower to that engine. The semiconductor industry is a cornerstone of the state manufacturing industry. Economic development experts indicate that Washington has lost a competitive edge and that we are now middle-of-the-pack. It is an extremely competitive global market. We know that there is a big investment opportunity around the corner.

The Columbia River Economic Development Council sees real opportunities to increase investment in the semiconductor materials manufacturing subsector. It is the heart of the semiconductor manufacturing industry in Washington. We have the opportunity to attract the only proposed facility in which 300mm wafers would be manufactured in the United States. Seventy percent of their product would be exported.

Testimony Against: None.

Persons Testifying: Representative Wallace, prime sponsor; Mark Brown, City of Vancouver; and Bart Phillips, Columbia River Economic Development Council.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill by Committee on Technology, Energy & Communications be substituted therefor and the substitute bill do pass. Signed by 11 members: Representatives McIntire, Chair; Hunter, Vice Chair; Orcutt, Ranking Minority

Member; Roach, Assistant Ranking Minority Member; Ahern, Condotta, Conway, Ericks, Hasegawa, Santos and Shabro.

Staff: Mark Matteson (786-7145).

Summary of Recommendation of Committee On Finance Compared to Recommendation of Committee On Technology, Energy & Communications:

No changes recommended.

Appropriation: None.

Fiscal Note: Preliminary fiscal note is available.

Effective Date of Substitute Bill: The bill contains a contingent effective date and takes effect as follows: Sections 2 through 8, the substantive provisions concerning tax incentives for semiconductor materials manufacturing, become effective on the first day of the month following a determination by the DOR that, based on actual expenditures prior to commercial production, an investment of at least \$350 million in an advanced semiconductor materials manufacturing facility has taken place at the time commercial production began. Section 1, the Legislative intent, and section 9, governing the criteria with respect to the effective date for sections 2 through 8, take effect 90 days after adjournment of the session in which the bill passed.

Testimony For: In 2003, the Legislature enacted semiconductor incentives that were contingent on the investment of at least \$1 billion in new facilities. In reality, that is not how this industry develops. Initial investment tends to be in the range of several hundred million dollars, and with incremental additional investment grows to \$1 billion over time.

The City of Vancouver supports this proposal. This bill will add more horsepower to the Clark County economy's engine. The semiconductor industry has been at the heart of the economic engine for the last decade. Over 90 percent of the state's semiconductor sales originate in Clark County. This is important for both the county and the state. This industry has created 2,200 great-paying jobs. We want to grow the base. We've lost the competitive edge - we're now a middle-of-the pack competitor. This bill is very precisely targeted. The city is constantly meeting with companies. We know right now that an opportunity exists out there.

The 2003 investment contingency was for \$1 billion in a state-of-the-art microchip manufacturing facility. The problem is that this industry went sideways at the time and is still dealing a bit with overcapacity issues. What we did not anticipate was the rapid demand for advanced semiconductor materials. The market value of 300 millimeter silicon wafers is between \$300 and \$500, whereas for the standard eight-inch wafer it is about \$40.

Testimony Against: None.

Persons Testifying: Representative Wallace, prime sponsor; Mark Brown, City of Vancouver; and Bart Phillips, Columbia River Economic Development Council.

Persons Signed In To Testify But Not Testifying: None.